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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-617

RAYMOND GREENBERG AND MARILYN GREENBERG,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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October 1975

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit, entered in the above-entitled case on July 28, 1975.

CITATION TO OPINIONS BELOW

The findings of fact and opinion of the United States Tax Court printed in Appendix B hereto, *infra*, pp. 3a-33a are reported in 62 United States Tax Court Reports at pages 331-351. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, *infra*, pp. 34a-35a is as yet unreported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 28, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

1. When four corporations carrying out *some* separate business activities are liquidated, and a fifth corporation remains unliquidated, can the resulting distributions be lawfully treated as dividends rather than capital gains?

2. Does a Tax Court subpoena, pursuant to which an Internal Revenue agent acquires documents for taxable years that have previously been examined, violate the provisions of Section 7605 (b) of the Internal Revenue Code, limiting the Commissioner's power to examine a taxpayer's records to one such examination for each taxable year?

STATUTES INVOLVED

The statutory provisions involved are Sections 331(a), 1202 and 7605(b), Title 26, United States Code (Internal Revenue Code). These provisions are printed in Appendix A, *infra*, pp. 1a-2a.

STATEMENT

The jurisdiction of the United States Tax Court was invoked pursuant to Section 6213 of the Internal Revenue Code; the jurisdiction of the Court of Appeals to review the decision of the Tax Court is based on Section 7482 of that Code.

This case arose from a proceeding in the Tax Court which had sought redetermination of a deficiency as-

serted by the Commissioner of Internal Revenue (hereinafter referred to as "Commissioner") with respect to taxpayers' Federal income tax returns for the calendar years 1966 and 1967. Following the filing of the petition, answer and amended answer, trial was held before the Honorable Irene F. Scott, Judge. A pretrial hearing on taxpayers' motion to quash subpoenas *duces tecum* was held by the trial judge and resulted in an order which granted the motion in part and denied it in part. Since the parties had agreed to disposition of several of the adjustments in tax liabilities initially raised in the pleadings, the Tax Court was called upon to decide the sole question of whether the corporate liquidations in 1966 resulted in ordinary income or capital gain to the taxpayers. The Tax Court resolved that issue in favor of the Commissioner and entered its decision accordingly. The Court of Appeals affirmed in a *per curiam* opinion.

The facts related to the transaction in dispute are substantially undisputed. They show that as of May 20, 1966, taxpayer Raymond Greenberg (hereinafter referred to as "Greenberg") owned one half of the capital stock of five corporations, known as Colt Development, Inc., Colt Builders, Inc., Colt Homes, Inc., Colt Properties, Inc. and Colt Contractors, Inc. Greenberg also owned a 50% partnership interest in a partnership called Gerasi Associates from which the Colt corporations had from time to time acquired land and rented some of their equipment. The remaining capital stock in the Colt corporations and balance of partnership interest in Gerasi were owned by George Revitz. Pursuant to an agreement dated May 20, 1966, Revitz sold his one half interest in Gerasi to Greenberg and Colt Development, Inc. also redeemed Re-

vitz' stock interest in that corporation. Shortly thereafter, Greenberg and Revitz caused the other four Colt corporations to adopt resolutions for their complete liquidation whereby the assets of such corporations were to be distributed equally to Greenberg and Revitz. The amount of distribution with respect to each corporation appears in the findings of the Tax Court. The total distribution of $213,994.53 was reported on the taxpayers' joint income tax return as a capital gain. In accordance with that method of reporting these transactions, the taxpayers reduced that total by $106,997.27 representing the deduction under § 1202 of the Internal Revenue Code applicable to disposition of capital assets owned for more than six months, and included the balance in their gross income for the taxable year 1966. The Commissioner disallowed the § 1202 deduction holding the distributions to be reportable as ordinary income and the Tax Court upheld that determination.

The evidence before the Tax Court consisted of testimony and a large quantity of documents, the authenticity of which was stipulated, but most of which were admitted over the taxpayers' objection.

The taxpayers' direct testimony consisted of evidence which showed that their accountant had been served with a subpoena to appear at the trial of this case and to produce numerous books and records. The testimony further revealed that in substantial part the records referred to had been previously examined by the Internal Revenue Service. The accountant testified that he turned the books over to the Internal Revenue Agent as a result of the subpoena and that he did so at the direction of taxpayers' counsel. The agent himself testified that he had been assigned to

assist counsel for the Commissioner in this case and that the purpose of the examination conducted by him was "to show that the five corporations are actually one single operation." Rebuttal testimony from Greenberg showed that in connection with the subpoena served on him, he made seven file cabinets of records available to the agent and that some of these materials extended back as far as 1958.

The evidence showed that the five Colt corporations were organized in 1959 and 1960 by Greenberg, Revitz and a third person who disposed of his stock ownership in 1964. The various corporations at all relevant times until May 1966, were engaged in the construction of single family dwellings in Montgomery County, Maryland. After the liquidation of four of the corporations, Colt Development, Inc. continued with these activities, but constructed a substantially fewer number of houses than the five corporations had done prior to that time.

The five corporations were initially formed by the same three persons, one of whom was Greenberg. Their corporate charters were identical and their bylaws were essentially similar. In 1958, the same individuals formed a partnership (Gerasi) which acquired the land on which the Colt corporations built homes and transferred the same to those corporations, as construction progressed. Each of the five corporations engaged in its own construction activities, although so-called project costs were for the most part billed to and paid by Colt Development, Inc. and thereafter allocated among the other corporations. These allocations were based on the number of homes built by each corporation in a given year. As the Tax Court noted, actual construction costs, after building permits were

obtained and lots were transferred, were generally paid by the individual corporations. The five corporations untilized common office personnel and accounting procedures and incurred a number of expenses for their common benefit. Among those were legal and accounting, auto expenses, rent and office salaries. These expenses were paid by Colt Development, Inc. and subsequently allocated among the individual corporations. Advertising for sales of homes was similarly carried out in common, but the sales representative in two of the subdivisions testified that contracts for the sale of homes were entered into in the names of the separate building corporations. Construction contracts were entered into between the individual corporations and subcontractors either jointly or separately and, on occasion, with Colt Development, Inc. alone. Construction loans were made with respect to the individual homes built and were disbursed to the separate corporations, although the individual stockholders were usually liable on such loans.

Each of the three initial organizers of the five corporations including Greenberg testified on rebuttal. They testified that the principal reasons for the formation of the separate corporations were limitation of liability for negligence suits, subcontractors' claims, warranties made to purchasers and financial risks. Greenberg further testified that after May 1966, he decided to carry on his building activities through only one corporation because of a substantial reduction in the number of homes constructed; he estimated that he had built fewer than 100 homes since that time.

The taxpayers requested the Tax Court by motion to include the substance of the aforementioned rebut-

tal testimony, and of the testimony relating to inspection of records by the Internal Revenue Agent, in its findings. That motion was denied.

REASONS FOR GRANTING THE WRIT

I

This case is one of first impression. It represents the results of an attempt by the Commisioner—now sanctioned by both the Tax Court and the Court of Appeals—to treat distributions in complete liquidation of a number of corporations as being equivalent to a dividend, merely because of the previously related activities to another corporation which remained active. The lower courts upheld these actions on the part of the Commissioner, not because they are supported by the provisions of any statute, but as a consequence of the finding, that the four separate corporations were in effect "sham" entities and should be regarded as part of the single unliquidated business enterprise that continued to exist without interruption. The Court of Appeals in affirming the decision of the Tax Court in this case, has upheld a result that vests powers in the Commissioner of Internal Revenue that are far beyond those that are delegated by the Congress. To imply a grant of authority to disregard corporate entities under the facts of this case, presents a position that is totally at variance with the previous decisions of this Court and, we submit, is of such far-reaching public importance as to make review by this Court both desirable and appropriate.

Although initially having made the bare assertion that the distributions from the Colt corporations received by Greenberg were taxable as ordinary income

rather than capital gain, the Commissioner shortly before trial amended his answer to add two alternative theories. He stated that capital gain treatment should be denied either because the liquidated Colt corporations lacked a separate and independent business purpose, or because in accordance with the provisions of § 269 of the Internal Revenue Code, Greenberg and his associates had acquired their interests in the separate corporations for the purpose of evading or avoiding Federal income taxes. Of course, the first theory was adopted by the Tax Court and its decision rests on it. The alternative contention advanced is briefly referred to by the Tax Court, but no finding was made that § 269 applied, nor that the principal purpose of evasion or avoidance in fact existed. Accordingly, it may be assumed that the Tax Court rejected the alternative theory of § 269 and we are, therefore not addressing ourselves to it.

It was undisputed that Greenberg in May 1966 owned one half of the outstanding capital stock of the five Colt corporations and that at the time referred to, four of those corporations terminated their separate existence. It is also uncontroverted that one of the corporations, Colt Development, Inc. continued in the construction business after that time. Since the distributions received by Greenberg which are disputed here were of all of the assets of the four corporations, we submit that they fall squarely within the provisions of § 331 of the Internal Revenue Code. The pertinent portion of that section reads as follows:

> *"Sec. 331. Gain or Loss to Shareholders in Corporate Liquidations.*
>
> (a) General Rule.—
>
> (1) Complete liquidations.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock."

Inasmuch as no one questions that the capital stock in the four corporations was held for more than six months, it follows that the deduction of one half of the gain provided in § 1202 of the Code is applicable. The Tax Court recognized that if the transaction in question was governed by the aforementioned statute, the taxpayer must prevail. However, it concluded otherwise holding that the four liquidated corporations lacked a separate business purpose apart from the unliquidated corporation, and that, therefore, the distributions received are to be taxed as dividends.

In considering the applicability of Section 331, it should first be noted that nothing contained in this statute, or in any regulation promulgated by the Commissioner, in any way suggests that its provisions are available only to those taxpayers whom the Commissioner finds eligible. There is no element of discretion conferred on the Internal Revenue Service which would make these distributions qualify or not qualify as capital gains depending on whether they pass the test of meeting certain factual criteria. The Congress has established a single prerequisite for the treatment of liquidations under this statute, and that is the prerequisite of completeness. We are not dealing here with the allowance of deductions, which have often been described as matters of legislative grace. There

is no requirement or stipulation that could extend these provisions of law only to those corporations the formation of which was caused by motives the Commissioner approves. The entire record demonstrates that these corporations were distinct legal entities which had a long history of separate recognition by both the Government and the taxpayers. We submit that the Tax Court's inquiry should have ended here and the decision for the taxpayers should have followed. Instead, however, the lower court entered into an analysis of the facts which may have been relevant to a determination of whether related corporations are entitled to multiple surtax exemptions, but has no relationship to a resolution of the single question of whether the four corporations had been subjected to a complete liquidation.

We hasten to acknowledge that corporations which are straws, so-called "dummies," or otherwise have purely a paper existence, need not be recognized for tax purposes. A corporation, to be entitled to recognition for tax purposes, must carry out *some* business function. The frequently-quoted words in *Moline Properties* v. *Commissioner;* 319 U.S. 436, 63 S. It. 1132, 87 L. Ed. 1499 (1942) are meaningful here:

> "The doctrine of corporate entity fills a useful purpose in human life. Whether the purpose be to gain an advantage under the law of the State of Incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."

In an opinion by Judge Learned Hand, in *National Investors Corporation* v. *Hoey* (2nd Cir. 1944) 144 F. 2d 466, 467, the same principle is stated as follows:

> ". . . whatever the purpose of organizing the corporation, 'so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.' 319 U.S. 439, 63 S. Ct. 1134, 87 L. Ed. 1499. That, as we understand it, is the same interpretation which was placed on corporate reorganizations in Gregory v. Helvering, 293 U.S. 465, 55 S. Ct. 266, 79 L. Ed. 596, 97 A.L.R. 1355, and which has sometimes been understood to contradict the doctrine that the motive to avoid taxation is never, as such relevant. In fact it does not trench upon that doctrine; it merely declares that to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation: in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning; and that escaping taxation is not 'business' in the ordinary meaning."

The four liquidated Colt corporations clearly carried out "some" business functions within the meaning of these decisions. In fact, their activities were substantial, as the record demonstrates. They took title to lots, arranged to improve them, paid for construction, conveyed the completed homes to buyers and issued their own individual warranties.

There is not the slightest doubt that the business which Greenberg and his associates conducted through the means of the five corporations had many interrela-

tionships and common elements. They transferred land from a partnership organized by the same individuals, shared development expenses and paid many administrative costs through the medium of a single corporation and later allocated them among the others. But there were many important and valid business reasons that prompted the organizers to select separate corporations for doing business. According to the unrebutted testimony, they were both conscious and concerned about the risks inherent in the construction of homes. They had not previously undertaken projects of this magnitude and they were genuinely apprehensive regarding the hazards and potential disputes in dealing with purchasers as well as large numbers of subcontractors. The fact that in the course of exercising this business judgment, the managing officers of the Colt corporations would utilize a variety of common services, does not destroy the valid business purpose of limiting liability. *Southern Dredging Corp.*, 54 T. C. 705 (1970). It is difficult to comprehend the Tax Court's conclusion that the corporations were adequately insured against tort liability and that, therefore, the separateness of the corporations provided no valid business reason. It would seem to have been a matter of which the Tax Court could have almost taken judicial notice that, no matter how adequate insurance coverage may seem, diffusing the considerable hazards of the construction business among separate corporations necessarily has to be a business advantage. The Tax Court relies most strongly on its own decisions in *Aldon Homes,* 33 T. C. 582 and *Shaw Construction Company,* 35 T. C. 1102. Both of these cases present the classic "multiple corporation" issue in which the use of individual surtax exemptions is the principal tax benefit involved. In both instances, the

Court found that the individual corporations had no viable existence for tax purposes and held that their gross income should be taxed as though they were one entity. The statutory basis relied on in *Aldon* and *Shaw* was § 22(a) of the 1939 Internal Revenue Code which is the broad, almost all-inclusive, definition of "gross income," now contained in § 61(a) of the 1954 Internal Revenue Code. Apart from the fact that the Commissioner in his pleadings did not rely on § 61(a), we find the emphasis on *Aldon* and *Shaw* misplaced for other reasons. We submit that, as has been pointed out above, sound business reasons for separate corporations existed in the instant case. More importantly, however, we contend that a different standard must be used to decide the shamness question when the Commissioner seeks to deny the taxpayer the benefits of a statutory complete liquidation, as compared with the conclusion that the multiple gross income of several corporations is to be regarded as being that of a single enterprise.

It may well be that taxpayers such as those in *Aldon* and *Shaw* forfeit the benefits of separate surtax exemptions when they operate a multiple enterprise in this manner. However, here we are not dealing with the gross income of the corporations. We are faced with an attempt by the Commissioner to revoke or suspend a specific section of the Internal Revenue Code that prescribes the tax results of a complete liquidation. We submit that a different test of shamness applies here. Here the rule of *Gregory* v. *Helvering,* 293 U.S. 465, 55 S. Ct. 266, 79 L. Ed. 596 (1935) should be applied. This Court in *Gregory* disregarded the corporate entity because it found that the corporation had come into being without *any* business purpose

whatever for the sole purpose of taking advantage of certain reorganization provisions. There was an unmistakable and direct connection between an unneeded corporate entity and a predetermined tax result. We have no findings by the Tax Court that would sustain a shamness conclusion as in *Gregory,* predicated on the existence of pre-arranged tax scheme. A finding under § 269, which requires a tax evasion or avoidance purpose as an indispensable element, would pose a different problem, if the record showed a specific violation of that statute. However, the Tax Court reached no such conclusion. In fact, it barely mentions the Commissioner's § 269 argument and seemingly rejected it by clear implication.

There is no undefined, residual authority delegated to the Commissioner whereby he can arbitrarily strike statutes, or nullify their operation at will. It is significant that when the tax laws pertaining to multiple corporations were revised as part of the 1964 Revenue Act, the legislative history is silent on any intent to limit the provisions of § 331 upon liquidation of a member of an "affiliated group." It is apparent from the legislative history of the 1964 Act that Congress was fully aware of the statutory weapons available to the Commissioner through the use of Sections 269, 1551 and 482, whenever he perceived an allegedly improper use of multiple corporations. See: Senate Report to accompany H. R. 8363; 88th Cong. 2nd Sess. U. S. Code Cong. & Adm. News, pp. 1823-24.

The Tax Court appears to suggest that the benefits of § 331 are available to only those taxpayers who can prove that the liquidated corporation was not subject to challenge because of some possible tax advantage as a multiple corporation. We submit that this approach

violates all principles of interpretation that have been long accepted in this field. Not only should tax statutes not be extended beyond their clear meaning, but in case of doubt they should be most strongly construed against the Government. *Gould* v. *Gould,* 245 U.S. 151, 38 S. Ct. 53 (1917); *B & M Co.* v. *U.S.* (5th Cir. 1971), 452 F. 2d 986. As this Court has pointed out, the Congress has drawn meaningful distinctions between tax consequences of transactions depending on whether they occur at the corporate or shareholder level. *U.S.* v. *Cumberland Service Co.*, 338 U.S. 451, 70 S. Ct. 280, 94 L. Ed. 251 (1950). In the same way, the restrictions that can be lawfully imposed on multiple corporations cannot, without statutory authority be translated into new and different individual tax levies. The Tax Court noted that it had found no case dealing with the precise issue here presented. However, it referred to the case of *Walter L. Morgan,* 33 T. C. 30 (1959), reversed on other grounds (3rd Cir. 1961) 288 F. 2d 676. That case actually supports the taxpayer's position inasmuch as it was there held that the fact that a corporation's income was allocated to another corporation, did not deprive the stockholders of their right to treat gain from the liquidation of the first corporation as a capital gain. In reaching this result in *Morgan,* the Tax Court particularly emphasized that "disregard of corporate entities is an extraordinary legal technique" (33 T. C. at p. 41).

In the final analysis, it appears that what the Government seeks is a kind of punitive action that would impose serious monetary penalties on those who have utilized multiple corporations for tax purposes. To the extent that those penalties depart from specifically enacted statutes, they are, of course, invalid. Under the

prior rulings of this Court, and the decisions of many lower courts, the disregard of the corporate entity is indeed an extraordinary step. In our view, that step becomes all the more serious when its result is the effective suspension of an entire section of the Internal Revenue Code by converting capital gains to ordinary income. We submit that only the Congress can fashion such measures and consequences.

II

The Tax Court rejected taxpayers' argument that under the pretext of serving a subpoena *duces tecum,* the Commissioner had in effect conducted an illegal second examination of the corporations' books and records. Section 7605(b) of the Internal Revenue Code prohibits such a second examination, unless preceded by a written notice from the Commissioner, or requested by the taxpayers. No one has contended that the Commissioner gave the aforementioned notice, nor has it been denied that the records examined were reviewed for the second time. The Tax Court is simply in error in concluding that Greenberg had "in effect requested" the Internal Revenue Agent to inspect his files. The record shows that, following a pretrial hearing at which the Tax Court Judge quite properly encouraged the parties to stipulate undisputed facts, access to such records was given by both the accountant and Greenberg for that particular purpose. What took place, however, was the conduct of a giant fishing expedition in which the Commissioner's agent spent almost a full day searching for evidence calculated to show "that the five corporations are actually one single operation." We submit that the fact that the persons summoned could have produced the records at

trial is of no consequence. What the Government engaged in purely and simply was a second audit. Section 7605(b) prohibits such actions under these circumstances, and it does so without regard to whether the inspection is conducted for purposes of a trial, or otherwise. Mr. Zoslow was just as surely an agent of the Commissioner whether he gathered evidence for an assessment or to furnish assistance to Government counsel. Greenberg was simply lulled into cooperating with the agent in the mistaken belief that he was complying with the subpoena. What has taken place is a misuse of the Commissioner's power of examination in a manner which the above-mentioned statute seeks to prevent. *Pacific Mills et al* v. *Kenefick* (1st Cir. 1938) 99 F. 2d. 188. This Court has left no doubt that compliance with the prerequisite of notice under § 7605(b), in the absence of a taxpayer request, is an absolute prerequisite. *U.S.* v. *Powell,* 379 U.S. 48, 85 S. Ct. 248 (1964). Disregard of the statute is a proper basis for setting aside the deficiency. *Reineman* v. *U.S.* (7th Cir. 1962), 301 F. 2d 267. Accordingly, the Tax Court should have sustained the taxpayers' objections to introduction of evidence acquired in the above-described manner.

The limitation that the statute places on the Commissioner's power to examine taxpayers' records is founded on important public policy considerations, as the *Powell* decision makes clear. The record in this case demonstrates that the Internal Revenue Agent had a predetermined, but uncommunicated purpose to use the subpoena as a device to obtain access to the previously inspected books and records. In sanctioning this procedure, the courts below have allowed a mere formalism to thwart an unambiguous Congressional intent.

CONCLUSION

For the reasons heretofore stated, petitioners submit that the writ of certiorari should be granted.

Respectfully submitted

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October 1975

APPENDIX

APPENDIX A

Statutes Involved

Sec. 331. Gain or Loss to Shareholders in Corporate Liquidations.

[Sec. 331(a)]

(a) GENERAL RULE—

(1) COMPLETE LIQUIDATIONS.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

• • • • • • • • • •

Sec. 1202. Deduction for Capital Gains.

In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 percent of the amount of such excess shall be a deduction from gross income. In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any), of the gains for the taxable year from sales or exchanges of capital assets, which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

Sec. 7605. Time and Place of Examination.

• • • • • • • • • •

(b) Restrictions on Examination of Taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year un-

less the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

APPENDIX B

62 T. C. No. 41

UNITED STATES TAX COURT

RAYMOND GREENBERG AND MARILYN GREENBERG, *Petitioners* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent*

DOCKET NO. 176-71

FILED JUNE 18, 1974

Petitioner and two other persons organized a corporation (D) to engage in land development and building of single family houses. Subsequently they organized four other corporations in which they each held the same proportion of stock as they held in D. The four other corporations had no office separate from D, no employees separate from D, and conducted no business independently of D. In May 1966 the four corporations other than D each adopted resolutions of liquidation and distributed to the stockholders their assets which consisted, except for approximately $2,000 in one of the corporations, of cash and notes and accounts receivable. D redeemed all of its stock except that held by petitioner and petitioner continued to conduct the home building business through D of which he was then the sole stockholder.

Held: The four liquidated corporations were shams, having no operations or business apart from that of D. In substance upon the liquidation of the four corporations, D distributed earnings and profits to petitioner. The distributions constitute dividends taxable as ordinary income to petitioner whether the formation of the corporations other than D is ignored and the distribution considered to be a direct distribution of earnings and profits from D to petitioner or the

stock purchased by petitioner in the four corporations is considered in substance to be additional stock in D. Under the latter view the distribution to petitioner in redemption of part of his stock in D is a distribution essentially equivalent to a dividend within the meaning of sec. 302(b)(1), and under sec. 302(d) constitutes a distribution of property to which sec. 301 applies.

Werner Strupp, for the petitioners.

Thomas C. Morrison and *Howard L. Williams,* for the respondent.

SCOTT, *Judge:* Respondent determined deficiencies in petioners' Federal income taxes of $92,555.15 and $11,462.60 for the taxable years ending December 31, 1966 and 1967, respectively. Some of the issues have been disposed of by the parties leaving for decision whether petitioner's multiple real estate corporations were shams for tax purposes so that $213,994.53 received upon the purported "liquidation" of four of the five corporations is a distribution to petitioner from the surviving corporation in the nature of a dividend taxable as ordinary income to him.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. Petitioners Marilyn and Raymond Greenberg are husband and wife and resided in Bethesda, Maryland at the time their petition in this case was filed. They filed their joint Federal income tax returns for the calendar years 1966 and 1967 with the district director of internal revenue at Baltimore, Maryland.

Raymond Greenberg (hereinafter sometimes referred to as petitioner) is in the real estate development business and had been in that business for a number of years prior to the years here at issue. Prior to 1966 he joined with Simon Sherman (hereinafter Sherman) to form Colt Con-

struction Company partnership for the purpose of constructing about ten houses in an area called Colt Terrace in Wheaton, Maryland. After this project had been completed, petitioner, Sherman, and George Revitz (hereinafter Revitz) decided to develop large residential subdivisions. With the advice and assistance of their accountant, in December 1958 they formed Gerasi Partnership (hereinafter Gerasi), each of them being an equal partner. They also formed five corporations, the names and dates of incorporation of each entity being as follows:

Name*	Total Capital Contribution	Total Shares Issued	Date Incorporated
Colt Development, Inc. (Development)	$3,000	1,500	2/ 3 /59
Colt Builders, Inc. (Builders)	3,000	1,500	5/21/59
Colt Homes, Inc. (Homes)	3,000	1,500	6/ 2 /59
Colt Properties, Inc. (Properties)	3,000	1,500	2/15/60
Colt Contractors, Inc. (Contractors)	3,000	1,500	2/29/60

* The five corporations will hereinafter be referred to collectively as Colt corporations or Colt entities.

Petitioner, Sherman, and Revitz each contributed $1,000 and received 500 shares of no par common stock of each corporation. At all times each Colt corporation had only one class of stock.

Gerasi and the five Colt corporations were engaged in the development, construction, and sale of single family houses in two areas, Burnt Mills Park and Foxhall, both areas being located in Montgomery County, Maryland.

Gerasi acquired construction equipment which it rented to the five Colt corporations.

The articles of incorporation of each of the Colt corporations contained similar provisions for each one's incorporation under the laws of Maryland, corporate powers, and original directors (Sherman, Greenberg and Revitz). These articles set forth in identical clauses each corporation's limitations and regulations, and designated the same principal office and registered agent. The by-laws of each corporation were essentially the same, with the exception of different prescribed days and times for stockholders' and directors' meetings. Each corporation's minute books recorded similar resolutions regarding officers' compensation, a bank account with Suburban Trust Company, and, in the case of Builders, Contractors, Homes, and Properties, liquidation of the corporation.

The development and sale of the first Colt subdivision known as Burnt Mills Park was carried out in the following manner: Gerasi purchased the first tract of land consisting of 60 lots and simultaneously transferred the land at cost to Development on March 23, 1959, before any of the other Colt corporations had been formed. Development retained 24 lots, conveyed 15 lots to Builders in June 1959, 20 lots to Homes in September 1959, and 1 lot to Homes in March 1960. Gerasi purchased a second Burnt Mills Park tract in February 1960 consisting of 50 lots from which it transferred at cost 20 lots to Properties and 17 lots to Contractors, both of which had been recently created, and 12 lots to Development over the remainder of 1960 and 1961. A thirteenth lot was transferred to Development in 1963.

Some time in 1960 Gerasi purchased lots in the Foxhall subdivision and in a manner similar to that used for lots purchased in Burnt Mills Park distributed most of these during 1961 through 1967 to the various Colt corporations, transferring a total of 76 lots to Development, 46 lots to

Builders, 58 lots to Homes, 57 lots to Properties, and 52 lots to Contractors. Payments for lots were treated as open account indebtedness between Gerasi or Development and the appropriate corporation, that is, as an account payable by the Colt corporation and an account receivable by Gerasi or Development. The Colt corporations took the lots subject to purchase-money obligations executed by Gerasi to the sellers. As each lot was sold, the Colt corporation holding title paid the original sellers the necessary amount to release the underlying purchase-money lien.

The subdivision plan for Burnt Mills Park had already received approval of the appropriate government authority and was formally dedicated prior to Gerasi's purchase. With respect to Foxhall, Gerasi formally dedicated all plats of the subdivision.

With regard to both Burnt Mills Park and Foxhall, Gerasi and/or Development obtained the necessary permits for grading streets and roadways. Development furnished subdivision bonds and conducted various transactions with the Montgomery County Department of Public Works and the Washington Suburban Sanitary Commission regarding storm drains and sewers on behalf of the entire subdivision.

Development was billed and paid for the extensive engineering work necessary to prepare both development sites for subdivision and construction of houses. These expenses included:

> Boundary survey, topographic surveys, tentative subdivision plan, street grade and profile design, street grade stakeout, street grade permit application, record plats, petition preliminary stakeout and compliance with authority for sewer and water, stakeout property points for construction of sewer and water, storm drain study, storm drain design and paving plan, storm drain stakeout, paving stakeout, permit applications, development plans, lot stakeouts, house

stakeouts, first floor grades, wall check surveys, final house location surveys.

All project costs including rental of construction equipment from Gerasi were billed to and paid for directly by Development. At the end of each Colt corporation's fiscal year, Development allocated to it an amount representing its share of project costs which was determined by multiplying the number of houses it sold during the period by a flat per house rate. General journal entries of Development show typical amounts charged to each corporation for project costs as follows:

Charged To	Date of Journal Entries Made by Development	Fiscal Year Ended	Number of Houses	Total Amount	Per House Rate[2]
Development[1]	10/31/62	10/31/62	12	$54,300	$4,525.00
Properties	12/31/62	11/30/62	17	76,925	4,525.00
Builders	4/ 1/63	1/31/63	11	48,675	4,425.00
Contractors	4/30/63	2/28/63	1	4,425	4,425.00
Homes	4/30/63	3/31/63	9	43,200	4,800.00
Development	10/31/63	10/31/63	14	67,960	4,835.00
Properties	12/31/63	11/30/63	17	82,195	4,835.00
Builders	4/ 1/64	1/31/64	12	58,020	4,835.00
Contractors	4/30/64	2/29/64	25	121,750	4.870.00
Homes	5/31/64	3/31/64	15	76,350	5,090.00
Development	10/31/64	10/31/64	16	85,520	5,345.00
Properties	2/ 1/65	11/30/64	13	85,520	[3]6,578.46
Builders	4/ 1/65	1/31/65	16	74,960	4,685.00
Contractors	4/ 1/65	2/28/65	18	94,410	5,245.00
Homes	5/31/65	3/31/65	18	94,410	5,245.00

[1] Portion of project costs was retained on Development's book entries representing its share of these expenses.

[2] In those instances where the journal entries did not show the per house rates the interpolated amount is given.

[3] Officers' salaries for this year were determined on a basis of 13-home sales. However, the amount of the project cost allocation per house seems out of line and the total project cost amount more nearly coincides with 16 houses which there is some indication in the record might be the correct number.

Actual construction costs, predominantly consisting of all expenses incurred after building permits were obtained and lots were transferred to the various Colt entities, were generally paid by the appropriate Colt corporation.

General and administrative expenses, along with advertising expenses, were paid by Development and then allocated to the other Colt corporations. Included among these expenses were accounts labeled legal and accounting, auto expense, rent, office salaries, taxes-payroll, donations, promotion, dues, and subscriptions. Allocations were made per month on a percentage basis and the percentage allocated to each corporation varied from month to month.

Advertising of Burnt Mills Park and Foxhall homes appeared in the Washington Post and Washington Star newspapers. These advertisements used the words "Built by Colt," or solely identified the project with Development, and did not reveal the existence of Gerasi or the other Colt entities. Development was billed and paid for all ad costs as well as all indoor and outdoor home display signs.

The books and records of all five Colt corporations were maintained by one bookkeeper in a single office. Each set of books identified many construction cost accounts with the same account code numbers. Of 49 construction cost accounts, 43 accounts involved payments to at least one subcontractor common to all five Colt corporations; five accounts involved payments to one subcontractor common to four Colt corporations; and one account involved payments to one subcontractor common to three Colt corporations. The Colt records show payments to other subcontractors not common to all Colt corporations, but these payments generally represent small, isolated transactions. The common subcontractors generally charged each corporation the same prices for work on the same type of house but the charges varied in accordance with the type of house being built. The styles and designs of Burnt Mills

Park and Foxhall houses were rambler, split-level, or two-story configurations. The variation in style and design was necessary to fulfill an FHA requirement. There was no specialization among the five Colt corporations in constructing any particular style of house.

Sometimes, a subcontractor would execute a single subcontracting agreement with all participating Colt corporations. Another typical arrangement was that a subcontractor would simultaneously enter into separate subcontracts with each Colt corporation, using identical terms and prices. Upon occasion, a subcontractor would contract solely with Development for work on houses owned by Development and also houses owned by other Colt corporations. To obtain favorable prices for work, each Colt corporation would execute subcontracts involving a sizable number of houses. Even contracts with subcontractors who had not previously done work for any of the Colt corporations would be for work on at least 25 houses in a 100-house subdivision.

Subcontractors sometimes through error directed their billing statements to the wrong Colt corporation. When this happened, the entity receiving the bill would stamp it with a rubber stamp providing the Colt portion of the corporation's name and a blank space for designating the particular Colt entity tendering payment.

At all times here relevant, the five Colt corporations either together or separately maintained substantial and adequate liability insurance policies covering all risks arising from potential workmen's compensation claims and all other general liabilities. On February 12, 1965, their insurance broker was providing the following coverage:

(1) Workmen's compensation coverage on carpenters and/or laborers for an estimated payroll of $60,000; on clerical employees for $7,000; and on executive supervisors exercising supervision through superintendents and foremen, but no direct supervision, for $40,000. This policy covers Washington, Maryland, and Virginia.

(2) General liability coverage of $500,000/$1,000,000, including $25,000 property damage.

Gerasi also carried a contractor's equipment policy which covered liability insurance for various construction equipment.

The Colt corporations were additionally protected by certificates of insurance from the various subcontractors. For example, the insurance coverages carried by one of Colt's subcontractors, Contee Sand and Gravel Company, Inc., were as follows:

> Comprehensive General Liability—Bodily Injury, $500,000 each person, $1,000,000 each accident
>
> Comprehensive General Liability—Property Damage, $100,000 each accident, $300,000 aggregate
>
> Comprehensive Automobile Liability—Bodily Injury, $500,000 each person, $1,000,000 each accident
>
> Comprehensive Automobile Liability—Property Damage, $100,000 each accident

Most subcontractors also carried workmen's compensation coverage.

All Burnt Mills Park and Foxhall homes were sold on a commission basis exclusively through an independent real estate agency. The real estate agency uniformly used a preprinted contract form for all home sales. The contract form showed only the printed name of the real estate agency and subdivision. Upon sale of a home, petitioner, Revitz, or Sherman would execute the sales contracts and indicate the name of the appropriate Colt entity as seller.

The following schedules reflect the Colt corporations' taxable income and earned surplus and retained earnings as reported on their Federal income tax returns for the years 1959 through May 31, 1966:

TAXABLE INCOME

Taxable Year Ended	DEVELOPMENT 2-3-59 to 5-31-66	PROPERTIES 2-15-60 to 5-31-66	BUILDERS 5-21-59 to 5-31-66	CONTRACTORS 3-1-60 to 5-31-66	HOMES 6-2-59 to 5-31-66
• 10-31-59	$26,769.97				
• 1-31-60			$24,505.72		
• 3-31-60					$25,132.24
10-31-60	13,879.96				
• 11-30-60		$26,166.05			
1-31-61			$17,029.55		
• 2-28-61				$26,780.68	
3-31-61					$17,643.72
10-31-61	24,603.04				
11-30-61		26,555.72			
1-32-62			(3,729.88)		
2-28-62				20,083.99	
3-31-61					$12,020.32
10-31-62	18,522.10				
11-30-62		25,914.39			
1-31-63			24,294.67		
2-28-63				8,205.62	
3-31-63					17,999.77
10-31-63	18,846.09				
11-30-63		26,858.17			
1-31-64			21,167.42		
2-29-64				40,009.46	
3-31-64					39,815.29
10-31-64	37,269.54				
11-30-64		62,181.71			
1-31-65			38,841.05		
2-28-65				67,377.45	
3-31-65					66,460.98
10-31-65	114,860.77				
11-30-65		78,780.90			
1-31-66			77,471.60		
2-28-66				88,355.31	
3-31-66					93,664.73
• 5-31-66	12.89				
• 5-31-66		(918.35)			
5-31-66			169.05		
• 5-31-66				26,596.44	

• Short Periods

EARNED SURPLUS AND RETAINED EARNINGS

Taxable Year Ended	DEVELOPMENT 2-3-59 to 10-31-66	PROPERTIES 2-15-60 to 5-31-66	BUILDERS 5-21-59 to 5-31-66	CONTRACTORS 3-1-60 to 5-31-66	HOMES 6-2-59 to 5-31-66
• 10-31-59	$18,349.59				
• 1-31-60			$17,154.00		
• 3-31-60					$17,563.48
10-31-60	28,062.52				
• 11-30-60		$18,059.70			
1-31-61			29,074.68		
• 2-28-61				$18,354.71	
3-31-61					29,914.08
10-31-61	45,282.65				
11-30-61		36,306.93			
1-31-62			25,288.80		
2-28-62				32,413.50	
3-31-62					38,328.30
10-31-62	58,248.12				
11-30-62		54,245.84			
1-31-63			43,470.04		
2-28-63				38,157.43	
3-31-63					50,928.14
10-31-63	71,440.38				
11-30-63		72,637.76			
1-31-64			58,287.23		
2-29-64				63,238.97	
-3-31-64					76,110.34
10-31-64	96,700.92				
11-30-64		110,496.22			
1-31-65			84,874.99		
2-28-65				104,064.70	
3-31-65					116,545.29
10-31-65	162,628.13				
11-30-65		157,870.95			
1-31-66			131,660.20		
2-28-66				156,509.46	
3-31-66					171,750.95
• 5-31-66		157,881.00			
• 5-31-66			130,741.85		
• 5-31-66				156,641.32	
• 5-31-66					192,081.10

• Short Periods

For the following taxable years, Gerasi reported the following on its partnership returns (form 1065) for the calendar years indicated:

	1960	1961	1962	1963	1964	1965	1966
Income							
Rent	$13,053.33	$11,878.34	$16,765.00	$21,594.00	$23,854.00	$25,217.00	$ 16,979.00
Misc.	76.44	4.38					2,477.21
Int.							171.44
Cap. Gains On Lot Resale	None	None	None	None	None	None	[1] 141,505.76
Total	$13,129.77	$11,882.72	$16,765.00	$21,594.00	$23,854.00	$25,217.00	$161,093.41
Expenses							
Misc.[2]		$ 122.73	$ 390.60	$ 6.46	$ 685.00	$ 4,350.18	$ 15,729.96
Deprec.	$ 8,316.03	3,815.74	12,776.48	15,485.52	12,912.37	9,842.06	13,233.01
Rep. & Maint.	4,726.68	2,833.90	4,030.45	12,444.16	8,008.81	5,610.10	2,024.31
Ins.	202.76	183.14	715.75	1,335.12	1,514.28	1,959.74	2,158.17
Int.	9,201.85	15,110.58	19,503.40	12,459.27	5,347.79	13,039.51	3,450.41
Tax (Gen.)[2]	[2] 6,176.94	817.76	639.13	2,320.51	2,121.60	2,667.64	[2] 3,671.16
Tax (R.E.)[2]		5,349.95	11,151.12	8,448.20	4,580.44	6,379.86	
Total	$28,624.26	$28,234.00	$49,206.93	$52,499.24	$35,170.29	$43,849.09	$ 40,267.02
Net Gain							$120,826.39
Net (Loss)	(15,494.49)	(16,351.28)	(32,441.93)	(30,905.24)	(11,316.29)	(18,632.09)	
To: Greenberg	(5,164.83)	(5,450.43)	(10,813.97)	(10,301.75)	(5,658.15)	(9,316.05)	60,413.20
Revitz	(5,164.83)	(5,450.43)	(10,813.99)	(10,301.74)	(5,658.14)	(9,316.04)	
Sherman	(5,164.83)	(5,450.43)	(10,813.97)	(10,301.75)			
Greenberg's Wife							60,413.19

	1962		1963		1964		1965		1966
Invest. Credit	10-yr	5-yr	10-yr	4-yr	10-yr	5-yr	10-yr	4-yr	8-yr
To: Greenberg	$270.21	$212.67	$20.67	$1,453.33	$494.20	$202.53	$31.95	$1.004.20	$198.07
Revitz	270.21	212.67	20.66	1,453.34	494.20	202.53	31.95	1,004.19	198.07
Sherman	270.21	212.67	20.67	1,453.33					

[1] Partnership listed itself as in the business of constructing homes. Gross profit of $141,505.76 is derived from gross sales totaling $698,653 minus construction costs of $557,148.

[2] Specific allocation of taxes for the years 1960 and 1966 is unavailable.

Initially, Sherman was president of each of the five Colt corporations; Greenberg was vice-president and treasurer; and Revitz was secretary.

Pursuant to a single buy-out agreement dated June 8, 1964, Sherman redeemed his shares in each Colt corporation and sold his one-third interest in Gerasi to Greenberg and Revitz. After June 8, 1964, Revitz was president of each of the five Colt corporations and Greenberg was secretary and treasurer.

Pursuant to a single agreement dated May 20, 1966, Greenberg purchased Revitz' interest in Gerasi, and Revitz redeemed his 500 shares in Development; then Greenberg and Revitz simultaneously "liquidated" Builders, Contractors, Homes, and Properties. After May 20, 1966, Greenberg was president of the then "unliquidated" Development and assumed the title of president for the then "liquidated" Builders, Contractors, Homes, and Properties for the purpose of carrying out final post-liquidation matters.

In early years each Colt entity paid officers' salaries to petitioner, Sherman, and Revitz which were authorized by separate corporate resolutions. After October 1962, general journal entries show that officers' compensation was being calculated on an identical per house basis. Petitioner, Sherman, and Revitz were paid $1,500 per house by each Colt entity until Sherman withdraw from the business and thereafter petitioner and Revitz each received $1,700 and $2,000 per house. Development also had paid employees in addition to its officers but at no time did any of the other Colt corporations have any such employees.

Interest expense on purchase money mortgages was paid by Gerasi and subsequently allocated to each Colt corporation by means of appropriate journal entries.

Construction financing, as well as loans to Gerasi for acquisition of the land, was provided by Interstate Build-

ing Association, H. L. Rust Company, and Suburban Trust Company through individual mortgages on lots. These construction loans were secured by separate deeds of trust and separate insurance policies covering each house. The aggregate amount of the construction mortgage loan proceeds was disbursed among the Colt corporations weekly in a single transaction in accordance with a progress schedule. Petitioner, Sherman, and Revitz were usually required to personally endorse the mortgage notes for construction loans.

After Sherman left the business, petitioner and Revitz obtained additional operating capital through personal loans from Suburban Trust Company. On November 23, 1965, petitioner and Revitz each requested separate $300,000 one year loans from the trust company. Revitz' loan application stated in part:

> *Purpose* Loans to corporations for operating capital (Corporations will pay loans and accounts due to and from each other)
>
> *Source of Repayment* Liquidation of 4 corporations.
>
> *Collateral*—None—Suggest we obtain a guarantee from GREENBERG, et ux and vice versa on each $300,000 loan
>
> *Remarks*—Will maintain compensating balances in all accounts of at least $500,000. They have ample capital now to continue construction program in FOXHALL. Twenty-eight houses under construction (twenty under roof—eight footings, fourteen sold). Forty-three lots to be built upon. Have built and sold 280 houses in subdivision. After corporations are liquidated in one year, will continue building in one corporation and the partnership.

In a later related loan application on March 8, 1966, requesting an additional $50,000, Revitz again indicated the plans to liquidate "some" of the corporations in the following 3 to 6 months.

Prior to the liquidation of the corporations, petitioner and Revitz had disagreements concerning Revitz' right to engage in various unrelated business ventures exclusive of petitioner. In order to resolve their dispute, petitioner, Revitz, and Development entered into the previously mentioned buy-out agreement on May 20, 1966, providing for Revitz' sale to petitioner of his one-half interest in Gerasi for $172,292.52; for Development's redemption of Revitz' 500 shares of stock for $118,250.61; and Revitz' 500 shares of stock for $118,250.61; and Revitz' resignation as an officer and director of Development. In addition petitioner and Revitz agreed to cooperate with one another in effecting the final dissolutions of Homes and Properties before March 31, 1967.

On May 24, 1966, Greenberg and Revitz caused Builders, Contractors, Homes, and Properties to adopt identical resolutions of liquidation.

Consistent with these corporate resolutions, Builders, Contractors, Homes, and Properties filed final U.S. Corporate income tax returns for short tax periods ending May 31, 1966, which showed beginning balance sheets and final earnings as follows:

Beginning balance sheets on final returns:	BUILDERS	CONTRACTORS	HOMES	PROPERTIES
ASSETS:				
Cash	$163,299.49	$172,119.69	$161,361.02	$ 1,440.68
Notes and accounts receivable	21,238.57	14,150.80	20,666.46	185,877.35
Inventory	—	—	26,531.81	—
Buildings, other fixed assets	2,699.04	—	—	—
	$187,237.10	$186,270.49	$208,559.29	$187,318.03
	?	22,079.69	26,336.78	25,213.00
		$208,350.18	$234,896.07	$212,531.03
LIABILITIES:				
Accounts Payable	$ 7,598.53	$ —	$ 5,380.22	$ 3,501.06
Current Liabilities	—	—	1,500.00	—
Mortgages, notes, bonds (over 1 yr.)	10,214.53	40,560.83	9,876.11	12,606.49
Other liabilities/accrued taxes	34,763.84	8,279.89	43,388.79	35,552.53
	$ 52,576.90	$ 48,840.72	$ 60,145.12	$ 51,660.08

EQUITY:				
Paid-in capital	3,000.00	3,000.00	3,000.00	3,000.00
Earned surplus	131,660.20	156,509.46	171,750.95	157,870.95
	$187,237.10	$208,350.18	$234,896.07	$212,531.03
Final reported earned surplus	$133,741.85	$159,641.32	$195,081.10	$160,881.00
Less: Treasury Stock from Sherman Redemption	20,429.08	22,079.69	26,336.78	25,213.00
Adjusted final earned surplus	$113,312.77	$137,561.63	$168,744.32	$135.668.00
½ adjusted final earned surplus	$ 56,656.38	$ 68,780.81	$ 84,372.16	$ 67,834.00

Consistent with the May 24, 1966, separate resolutions, information returns were filed, showing the following distributions as of May 31, 1966:

	Builders	Contractors	Properties
CASH			
to Greenberg	$ 481.70	$ 77,321.21	$ 7,836.89
to Revitz	481.70	77,321.20	7,836.88
Total	$ 963.40	$154,642.41	$ 15,673.77
NOTES AND ACCOUNTS RECEIVABLE			
to Greenberg	$ 54,078.43	$(8,540.39)	$ 59,997.11
to Revitz	56,174.69	(8,540.39)	59,997.12
Total	$110,253.12	$(17,080.78)	$119,994.23
EQUIPMENT			
to Greenberg	$ 2,096.25		
to Revitz	—		
Total	$ 2,096.25		
Grand Total	$113,312.77	$137,561.63	$135,668.00
Greenberg's Total Share	$ 56,656.38	$ 68,780.82	$ 67,834.00
Revitz' Total Share	56,656.39	68,780.81	67,834.00
Total	$113,312.77	$137,561.63	$135,668.00

After the "liquidations" Development continued to construct and sell houses in Foxhall and subsequently in other areas of Montgomery County, Maryland. Gerasi began participating along with Development in the sale of Foxhall homes in 1966 and 1967.

After completion of the Foxhall subdivision, Development and Gerasi began building homes in Stonegate subdivision. Development entered into agreements with subcontractors for the construction of Stonegate homes as early as September 1966.

Development presently maintains an address in Stonegate, Silver Spring, Maryland. The Stonegate subdivision includes Crimson Oaks, the first part of which Development built. The remaining houses in Crimson Oaks were built by petitioner's wholly-owned and unincorporated Raymond Greenberg Construction Company. Development is also constructing homes in the 120-house Peachwood subdivision. In Peachwood, Development contracts to build houses for another partnership of which Greenberg is part owner.

With respect to the distributions received from Builders, Contractors, Homes, and Properties, Greenberg reported the following on his 1966 joint Federal income tax return:

	TOTAL	BUILDERS	CONTRACTORS	HOMES	PROPERTIES
Amount Realized		$42,367.03	$52,860.00	$68,134.32	$54,632.58
Cost of Stock		1,000.00	1,000.00	1,000.00	1,000.00
Gain Realized	$213,994.53	$41,367.03	$51,860.60	$67,134.32	$53,632.58
Less: Claimed sec. 1202 deduction	$106,997.27				
Net Gain Reported	$106,997.26				

Respondent in his notice of deficiency determined that the amounts reported by petitioner as capital gains received in exchange for his stock in fact constituted ordinary income and disallowed Greenberg's claimed section 1202 deduction.

ULTIMATE FINDINGS OF FACT

The four "liquidated" Colt corporations lacked any separate or independent business purpose apart from the unliquidated Development, whose inseparate and common building business was not terminated or otherwise interrupted by the four "liquidations."

The earnings and profits of the four "liquidated" Colt corporations were solely derived from the earnings and profits of a single business comprised of the five Colt corporations which business was not terminated nor otherwise interrupted by the four Colt corporations "liquidations."

OPINION

Although at the trial petitioner's objection to the introduction of certain evidence on the ground that it was obtained by respondent's agent Zoslow prior to the trial of this case in violation of section 7605(b), IRC 1954,[1] was overruled, petitioner on brief argues that we should reconsider this ruling and disregard this evidence. This evidence consists of parts of records which respondent subpoenaed from petitioner. Petitioner could have brought the requested records to court. Instead, "because of the scope and amount of material involved," he chose to allow respondent's agent Zoslow access to seven file cabinets from which to obtain information or copies from those

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[1] All references are to the International Revenue Code of 1954, unless otherwise noted.

SEC. 7605. TIME AND PLACE OF EXAMINATION.

• • • • • • •

(b) Restrictions on Examination of Taxpayer.—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

books and records requested in the subpoenas *duces tecum* for use at the trial. Zoslow's review of petitioner's files was with the permission of petitioner who chose not to ferret out the requested records by himself and in effect requested that the agent go over the subpoenaed records to relieve him of the trouble of bringing them to court. Section 7605(b) is not directed to circumstances such as here presented and none of the cases relied on by petitioner bear any factual resemblance to the facts here present. We will therefore not reconsider our ruling at the trial admitting evidence obtained as a result of Zoslow's inspection of subpoenaed records.

Respondent takes the position that distributions made to petitioner allegedly in liquidation of four of the five Colt corporations do not qualify for capital gains treatment, since the formal disolution of Homes, Builders, Contractors, and Properties did not interrupt or terminate petitioner's single integrated business enterprise of constructing residential subdivisions. Respondent bases his argument primarily on the contention that the multiple corporation were shams, that there was no real independent business purpose in their separate creation and utilization, and that thoughout the existence of all the Colt corporations in substance all income from the development and sale of property was earned by Development which continued in existence when the other corporations were liquidated. Respondent contends therefore that the distributions made to petitioner should not be considered liquidating distributions in exchange for petitioner's entire stock interest under section 331(a)(1) [2] because petitioner still holds 500 shares of Development which has not ceased

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[2] SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) General Rule. —

(1) Complete Liquidations.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

doing business, and that the amounts paid to petitioner are distributions of earnings and profits of an ongoing enterprise, taxable as ordinary income.

In the alternative, if we find that the four Colt corporations were not shams, respondent contends that capital gain treatment provided under section 331 must be disallowed because petitioner, along with Revitz and Sherman, acquired control of the Colt corporations for the principal purpose of the "evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance when such person or corporation would not otherwise enjoy." Section 269(a)(2).

We have faced the issue of the shamness of multiple corporations previously in *Aldon Homes, Inc.*, 33 T. C. 582 (1959), upon which respondent relies, and *Shaw Construction Company*, 35 T. C. 1102 (1961). Although there are slight gradations of tone and minor variations in texture, the facts and evidence in this case paint a picture which in essence is the same as the *Aldon* and *Shaw* cases. In *Aldon*, we found that the multiple corporations lacked any substantial business purpose for organization as such and that none of the corporations engaged in any independent substantive business activities. Therefore, we did not recognize their separateness for tax purposes and under section 22(a), IRC 1939, attributed their entire net income to one corporate taxpayer.

In *Shaw*, we again upheld respondent's attribution of all income derived from the development and sale of residential property to the taxpayer, Shaw Construction Company, based on our finding that "the multiple corporations • • • were shams, existing in name only, serving no business purpose and in reality performing no business or other functions." We consider respondent's position in the case at bar to be squarely supported by both these cases.

As we recognized in *Aldon* and *Shaw*, taxpayers are entitled to cast their business transactions so as to minimize their tax liability. *Gregory* v. *Helvering*, 293 U.S. 465 (1935); *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451 (1950). At the same time, the government may challenge and disregard the form so chosen if it is unreal or a sham. As stated in *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436, 439 (1943), so long as the purpose of a corporation "is the equivalent of business activity or is followed by the carrying on of business by the corporation" it remains a separate entity, but "in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction."

We have considered the evidence both documentary and testimonial in the record before us, and conclude that the Colt entities, other than Development, were not organized for any business purpose and did not engage in any business separate from Development. These corporations served served no purpose except to obtain a tax benefit which is not "business" sufficient to grant them recognition as separate "tax-worthy" entities for Federal tax purposes. *National Investors Corporation* v. *Hoey*, 144 F. 2d 466, 468 (C.A. 2, 1944); *Aldon Homes, Inc., supra*, at 597.

Petitioner contends that the five corporations were separate entities which took title to the property, arranged for improvements to lots, paid for construction and arranged the sale of homes thereon, and that use of five corporations instead of one was necessary to limit liability. Petitioner further contends that there is no evidence that he and his associates acquired control of the five Colt corporations for the principal purpose of evading or avoiding taxes, and that "even if there were such evidence, the proposed disallowance of the capital gain credit is clearly unauthorized by" section 269.

Finally, petitioner argues that, even if respondent can successfully show a lack of business purpose during the existence of a corporation, this does not preclude the applicability of section 331, "provided that the distribution in liquidation was made by a corporation having separate legal existence."

With regard to petitioner's primary contention, we do not consider the nominally separate activities of the Colt entities to reflect the operation of five independent businesses. It is clear from the evidence in the record that petitioner and his associates, either through Gerasi or Development, performed all work necessary to the development and sale of homes in Burnt Mills Park and Foxhall. The evidence shows that Homes, Builders, Contractors, and Properties were no more than shells. These "corporations" had no employees or assets, shared offices, officers, and directors, and did not do any business unless they could be considered to be doing business in the development of the two subdivisions, Burnt Mills Park and Foxhall, which in our view in substance they cannot. The actual development activities were planned and carried out as part of a single integrated venture, with no attempt to distinguish between the Colt entities. The organization of more than a single corporation added nothing to the enterprise and caused unnecessary duplication of bookkeeping and other activities. Petitioner justifies this wasteful duplication of activities by claiming that management feared tort and other liability inherent in developing a subdivision of such substantial size. Petitioner cites *Southern Dredging Corp.*, 54 T.C. 705 (1970), to illustrate that a business purpose of limiting liability warrants the creation and recognition of several corporations, despite identical ownership and management and similar business activities. In *Southern Dredging*, two brothers operating a partnership decided to organize four corporations, one of which leased and operated three dredges, each dredge being owned by a separate corporation. The formation of sep-

arate entities was precipitated by the expansion of operations into more hazardous dredging operations in inland waterways. We recognized the presence of a valid business purpose of insulating one corporation's assets against the others' liabilities in this hazardous activity. We stated that the fact that all four corporations shared the same offices, address, telephone, repair service, and management and had all their bookkeeping performed by one individual did "not detract from the validity of having separate corporations for the realistic purpose of limiting liability." *Southern Dredging Co., supra* at 721. We also noted that the formation of separate entities was further motivated by the fact that a prerequisite to the sale of a former part-owner's share of the business to the remaining owners was that they form separate corporations to protect his creditor's interest, a precaution readily understood in light of the fact that marine and liability insurance available was insufficient to eliminate the substantial tort risk involved. The circumstances in that case do not equate to the situation before us here. Petitioner's business is less hazardous and unpredictable than that of the taxpayer in *Southern Dredging Co., supra.* Tort risk in petitioner's business is not of such magnitude so that a single claim might exceed insurance coverage and jeopardize the well-being of the entire enterprise. Petitioner's business was adequately protected by insurance.

The hazards which the Colt entities faced in their construction business were similar to those encountered by the taxpayers in *Aldon* and *Shaw.* In each of those cases we rejected arguments that the need to limit various types of liability justified having multiple corporations. We reject these same contentions raised by petitioner. As we said in *Aldon, supra* at 598:

> There was little or no demonstration as to how they would operate to the economic benefit of Aldon or the alphabet corporations. Particularly is this true of the purpose to avoid the possibility of a "general claim"

against the total project. We are left to surmise what the nature of such a claim might be with little to stimulate our imagination in this respect, except the reference to a suit resulting from an accident in the development of another tract. This, however, would appear to fall under the limitation of tort liability purpose. The benefits to be derived in this area from the use of multiple corporations are likewise unclear, particularly in view of the known custom of construction companies, as well as most businesses, to carry liability insurance, and the operation of workmen's compensation laws. The income tax returns filed by the alphabet corporations wherein deductions were claimed by each, in substantially the same amounts, for both "General" and "Workmen's Compensation" insurance, indicate they were fully protected in both respects. The stockholders already had the benefit of a "corporate shield" in Aldon, and on the evidence shown, the seeking of additional insulation through the formation of 16 more "corporate shields" was at best of minimal business significance.

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We also see little merit in the contention that the use of multiple corporations was necessary to facilitate the handling of mechanics' liens. As a general rule mechanics' as well as materialism's liens, are related in time of filing and in liability to the particular building or improvement for which they are furnished, though this may be and frequently is changed by the contract or arrangement under which they are supplied. See 36 Am. Jur., Mechanics' Liens, secs. 167-175. Here the houses were built on a mass production basis, that is, construction was initiated on lots in the first block of the subdivision and progressed lot by lot up and down the streets until the entire tract was completed. Workers moved from house to house as their phase of the work was ready to be done. Presumably materialmen's and mechanics' liens attached to the houses as completed and it is not made clear to us how the use of multiple corporations would "ease the handling of mechanics' liens" to any greater extent. • • • The recited purpose relating to the handling of mechanics' liens, as in the case of the first two enumerated purposes, was but a "make weight" fac-

tor secondary to the parties' primary objective of avoiding taxes.

Sherman testified that he regarded the multiple corporate structure as vital to avoid potential problems with subcontractors. Although his testimony is unclear, we assume that he was referring to such problems as shoddy workmanship or a subcontractor's failure to perform work on schedule. However, he did not explain why problems such as these could not just as easily be minimized by a single corporation which could limit the amount of work given to any single contractor. Instead, more often than not, each Colt corporation contracted with the same subcontractors to perform a major part of the work throughout the entire development. Such practice is not consistent with the purported fear of problems with subcontractors.

Petitioner raised the proposition that the use of multiple corporations might minimize the financial risks of building a residential development of the magnitude of Burnt Mills Park or Foxhall but did not explain how this result would be attained. Since the Colt corporations built homes of the same style and price in the same development, unfavorable market conditions would most likely affect all five corporations in the same manner. In addition, petitioner, Revitz, and Sherman gave personal guarantees on construction and purchase-money loans on behalf of all five corporations, so that any claim arising from financial failure of a single Colt entity would necessarily have direct financial repercussions on all Colt entities. We find that this contention lacks merit.

It is not clear that the financial risks of the enterprise were ever really transferred to the Colt entities, since there is no evidence to show that the Colt entities assumed total liability for the purchase price of the Burnt Mills Park and Foxhall tracts. As the findings of fact reflect, Gerasi financed the purchase of the tracts and, as far as the record shows, remained primarily liable not only on

second mortgages in favor of the banks but also on first mortgages issued to the respective sellers. When the lots were transferred to or through Development to the other Colt entities, no funds were transferred to Gerasi as payment. Rather, the purchase price of the lot was simply shown in corresponding journal entries as an open account indebtedness until the lot was sold, at which time the respective Colt corporation would pay the portion of the sales price to obtain release of the seller's underlying purchase-money lien and, presumably, apply the balance to the amount owed to Gerasi. Since the brunt of liability remained on Gerasi, petitioner's multiple corporate structure did not alleviate this particular aspect of financial risk at all.

Anticipating our conclusion that the Colt entities were shams for tax purposes, petitioner submits that a finding of shamness and lack of business purpose of a liquidating corporation would not preclude the applicability of section 331, "provided that the distribution in liquidation was made by a corporation having separate legal existence." Petitioner does not refer us to any statute or case law to support this proposition.[3] Contrary to petitioner's position, application of the "sham doctrine" to the case at bar

[3] We have found no case specifically involving this issue. In the case of *Walter L. Morgan*, 33 T.C. 30 (1959), reversed on another issue 288 F. 2d 676 (C.A. 3, 1961), we held that assets of one corporation could not be allocated to another corporation under section 45, I.R.C. 1939 (now sec. 482, I.R.C. 1954), and concluded that a taxpayer was entitled to report gain on the liquidation of a corporation the gross income and deductions of which had been allocated to another corporation as capital gain. The respondent acquiesced in this holding and it was not involved in the appeal. In our view the *Morgan* case is distinguishable from the instant case both on its facts, the second liquidated corporation having had its income and deductions allocated to the corporation we held in the first issue to have been also properly liquidated, and as a matter of law, since our holding there related solely to the application of sec. 45, I.R.C. 1939, to the liquidation of a corporation.

logically precludes a finding that the transactions structured as liquidations under section 331 were in fact liquidations. To explain the impact of a finding of shamness, once we determine that the five Colt entities are in reality a single corporation, we attribute all earnings from sales of homes in Burnt Mills Park and Foxhall subdivisions to the single enterprise. Since this enterprise still exists as Development and continues to carry out the business of developing residential subdivisions under the Colt name, the distributions made by it cannot qualify for treatment under section 331 within the plain wording of the statute.

If the entire transactions in the formation and use of the corporations other than Development are ignored for lack of substance, then all that has occurred here is that Development has distributed its earnings and profits to its shareholder, petitioner. It follows that this distribution is a dividend to petitioner. In our view this is the proper conclusion as to the substance of what occurred under the facts here present.[4] The only other view that might be taken of the substance of the transaction is that petitioner's acquisition of "stock" in the other Colt corporations was in substance acquisitions of additional stock in Development, and in substance petitioner received earnings and profits of the corporation in redemption of a part of his stock in the corporate enterprise so that tax treatment of the distributions would be governed by section 302.[5]

[4] Petitioner makes no argument that in fact this is not the proper conclusion if we hold the Colt corporations other than Development were shams and that sec. 331 does not automatically apply to any corporation which has a legal existence under state law. Petitioner does not argue that if we hold the Colt corporations other than Development to be shams we should consider whether the purported liquidations of these corporations should be viewed as a partial liquidation of Colt and the facts in the records are not sufficient to make such a determination.

[5] SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) General Rule.--If a corporation redeems its stock (within

Section 302(a) allows exchange treatment, and concommitant capital gains on certain categories of redemptions outlined in section 302(b). Failure to qualify under one of

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the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) Redemptions Treated as Exchanges.—

(1) Redemptions not equivalent to dividends.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) Substantially disproportionate redemption of stock—

(A) In general.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) Limitation.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) Definitions.—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) Series of redemptions.—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not

the four categories set forth in section 302(b) results in amounts paid being treated as distributions of property under section 302(d) which, in conjunction with sections 301 and 316, causes the distribution to be ordinary income.

Section 302(b)(4) obviously does not apply in this case since that subsection is limited to certain railroad corporations.

Since petitioner has not terminated his interest in the Colt enterprise, he does not qualify under section 302(b)(3) for exchange treatment. Nor does the transaction fit within the confines of section 302(b)(2) which defines substantially disproportionate redemptions of stock. This leaves for our consideration section 302(b)(1) which permits capital gain treatment if the redemption is not essentially equivalent to a dividend.

The determination of whether a distribution is essentially equivalent to a dividend generally depends upon the facts and circumstances of each case, but in *United States* v. *Davis*, 397 U.S. 301 (1970), the Court stated that when a sole stockholder causes a part of his shares to be re-

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substantially disproportionate with respect to the shareholder.

(3) Termination of shareholder's interest.—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) Stock issued by railroad corporations in certain reorganizations.—Subsection (a) shall apply if the redemption is of stock issued by a railroad corporation (as defined in section 77(m) of the Bankruptcy Act, as amended) pursuant to a plan of reorganization under section 77 of the Bankruptcy Act.

• • • • • • •

(d) Redemptions Treated as Distributions of Property.—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b)), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

deemed the "redemption is always 'essentially equivalent to a dividend' within the meaning of that phrase in section 302(b)(1) * * *." In that case the Court further stated (at 313):

> If a corporation distributes property as a simple dividend, the effect is to transfer the property from the company to its shareholders without a change in the relative economic interests or rights of the stockholders. Where a redemption has that same effect, it cannot be said to have satisfied the "not essentially equivalent to a dividend" requirement of section 302(b)(1). Rather, to qualify for preferred treatment under that section, a redemption must result in a meaningful *reduction* of the shareholder's *proportionate interest* in the corporation. * * * [Emphasis supplied.]

Clearly, the petitioner's redemption of part of his stock in the Colt enterprises would not qualify under the holding in *Davis* since it would not be not essentially equivalent to a dividend. After the redemption, petitioner was the sole shareholder in the Colt enterprise. Therefore if the distribution to petitioner is viewed as a redemption of part of his stock in the Colt enterprise, section 302(d) imposes ordinary income treatment on amounts distributed to petitioner.

Because certain issues have been disposed of by agreement of the parties,

Decision will be entered under Rule 155.

UNITED STATES TAX COURT

Docket No. 176-71

Decision

Pursuant to the opinion of the Court filed June 18, 1974, and incorporating herein the facts recited in the respondent's computation as to the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income tax due from the petitioners for the taxable years 1966 and 1967 in the amounts of $88,151.38 and $6,711.20, respectively.

JUDGE.

Entered:

* * * * *

It is hereby stipulated that the foregoing is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision,

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 75-1084

RAYMOND GREENBERG and MARILYN GREENBERG, *Appellants,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Appellee.*

Appeal from the United States Tax Court.
Irene F. Scott, Judge.

Argued July 9, 1975 Decided July 28, 1975

Before CRAVEN, BUTZNER, and FIELD, Circuit Judges.

Werner Strupp for appellants; Carolyn R. Just, Attorney, Tax Division (Scott P. Crampton, Assistant Attorney General of the United States; Gilbert E. Andrews and Gary R. Allen, Attorneys, Tax Division, Department of Justice, on brief) for appellee.

PER CURIAM:

Raymond Greenberg and Marilyn Greenberg appeal from a judgment of the Tax Court holding that Mr. Green-

berg, a stockholder, received ordinary income rather than a capital gain from the liquidation of four corporations when he retained his ownership of stock in a fifth corporation which continued the business. We affirm on the opinion of the Tax Court. The court's crucial finding that the five corporations were really one business entity, which is amply supported by the evidence, justified treating distribution of the earnings and profits of the four liquidated corporations as substantially equivalent to a dividend.

We find no error in the Tax Court's refusal to quash a subpoena duces tecum directed to the taxpayers and their accountant, and in the consequent admission into evidence of documents obtained by execution of the subpoena. The facts do not support the taxpayers' charge that the subpoena was illegally used to conduct a second examination in violation of Section 7605(b) of the Internal Revenue Code.

Nor did the court abuse its discretion in denying a motion for a new trial so that the taxpayer could produce additional evidence in support of a claim of partial distribution, a theory that neither party had briefed for trial.

AFFIRMED.